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TO RUEHC/SECSTATE WASHDC 3474
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SENSITIVE

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TAGS: ECON EFIN ETRD EINV BR
SUBJECT: BRAZIL: AUTOMOBILE SECTOR MEASURES

REF: A) STATE 4753 B)SAO PAULO 0680 C) SAO PAULO 0207 D) BRASILIA 128 E) SAO PAULO 070

SENSITIVE BUT UNCLASSIFIED

¶1. (SBU) Summary: The government of Brazil, in addressing the global economic downturn's negative impact on its automotive sector, has implemented several measures aimed at freeing up credit lines, stimulating domestic demand and protecting domestic production. Reduced industrial product taxes on car purchases, new lines of credit for auto parts companies, the government acquisition of a large auto loan institution and a recently announced and rescinded import licensing requirement for imported cars (reftel D), are new GoB strategies intended to safeguard one of Brazil's largest manufacturing sectors that saw monthly car sales in December drop by over 20% from its high in June of 2008 (reftel C)and increased unemployment that contributed to the national job loss figure of 650,000 reported for December (reftel E). End Summary

DOMESTIC CONSUMPTION STIMULUS: SUCCESS?

¶2. (SBU) The GoB has announced a reduction in the industrial products tax (IPI) for cars. The tax, levied on most domestic and imported manufactured products and assessed at the point of sale by the manufacturer, was suspended on small car sales (from 7% to 0%) and reduced by 50% on large car sales (from 13% to 6.5%). The reduction, announced in December 2008 and scheduled to expire on March 31 2009, is designed to be a short term stimulus for the auto industry. Preliminary data indicates that Brazil's January car sales will exceed December's sales. Brazil's national car association (ANFAVEA) is forecasting January car sales of 215,000 compared to 195,000 in December, noting that the IPI reduction, which has reduced car prices from 5-10%, is already having a positive effect on demand. ANFAVEA also predicted that February sales would exceed January's. Toyota is rumored to have a waiting list again for new car deliveries and GM's Human Resources Director Edson Vaz confirmed that GM Brazil has cancelled its employee partial-pay extended leave program that was scheduled to start the beginning of February at the Gravatai Plant (Rio Grande do Sul State) in view of the increased demand for their 1.0 L vehicles due to the reduction of the IPI tax. A GM dealer in the Sao Paulo commented to Sao Paulo Econoff that sales have recovered because of the IPI tax and that business is picking up, but not at the same pace as before the crisis. Expressing uncertainty of what to expect after the IPI tax expires at the end of March, the dealer said that, despite dealerships being better off now than just a few months ago, car sales remain well below previous months' averages and staffing has not returned to pre-crisis levels.

¶3. (SBU) Further clouding the sector's future and possibly affecting additional government programs aimed at stimulating domestic

consumption is the current used car glut. The GM dealer explained that although the surplus has reduced used car prices and increased sales, it also has negatively impacted new car sales to those potential buyers relying on a high trade-in value of their used car in order to finance their purchases. The dealer confirmed that the business environment for car dealers is still very bad, but remains hopeful that the IPI tax reduction affect will bolster February's numbers.

CREDIT CRUNCH- GOVERNMENT INTERVENTION

¶4. (SBU) Attractive auto financing, a key contributor to Brazil's auto sector growth, significantly dried up as a result of the global downturn (reftel C), prompting the GoB to inject liquidity into the system and increase credit availability through the acquisition of a key auto lending institution. The GoB announced in November 2008 that Brazil's National Development Bank (BNDES) would provide loans of R$ 6.9 billion to small businesses and the automotive sector to ensure liquidity, production, sales and employment. The decision was made during a meeting with President Lula and the social and economic development ministries. The Minister of Finance, Guido Mantega, explained that R$ 4 billion of the loans would be targeted for the automotive industry with the objective of offering increased consumer financing options. Banco do Brasil recently purchased a 49.9% share in Banco Votorantim under provisional measure 443, another response to the global economic downturn which allows the purchasing of private financial institutions by Brazil's 2 main public banks. Banco Votorantim is a large corporate credit supplier as well as a major auto lender in Brazil, and with the purchase of 49.9% of Banco Votorantim, Banco do Brasil expects a 21% increase in the financing of cars through the expansion of credit. Banco do

Brasil, the largest publicly owned bank in Brazil, announced in January the availability of R$3 billion in loans for auto companies to finance the payment of taxes and employee bonuses. This line of credit will be available until March 2009. The GoB also announced that it would extend the corporate tax filing deadline for auto companies by 10 days.

IMPORT LICENSES

¶5. (SBU) Brazil's Ministry of Trade (MDIC) announced January, 27 2009 broad new import license requirements for imported products, impacting approximately 60% of Brazil's imports, including autos. The inadequately vetted measure was reportedly taken in response to a rapid decline in Brazil's trade balance. Preliminary data just released indicated that Brazil will record a January trade deficit of roughly 600bn USD, its first monthly trade deficit in nearly 8 years. By comparison, Brazil recorded a trade surplus of 900mn USD in January 2008.

AUTOS NOT THE ONLY SECTOR

¶6. (SBU) MDIC and Receita sources have indicated GOB is continuing to develop measures to provide relief for Brazilian industry, with particular focus on exporters. According to Receita, some measures will create permanent regulations for actions already taken ad hoc. Press reports this week indicate that exemptions for taxes on the importation of inputs and income tax exemptions for product certification costs overseas, among other potential measures, are being developed. Central Bank President Meirelles indicated this week that the Central Bank will expand the use of reserves to guarantee export financing. GOB hopes to table a package of measures by the end of February. Receita sources have highlighted the difficulty in targeting measures that provide relief for Brazilian industry while preserving tax revenues needed to fund the budget. MDIC sources have noted the need to focus on positive measures that promote exports without penalizing imports Brazil needs.

¶7. (SBU) Comment: The Brazilian Government has seen a need to address the sagging automotive industry that is a key sector in

President Lula's economic growth plan strategy. To date, it has taken a series of ad hoc and temporary measures such as the IPI tax break and the Bank of Brazil loan program. Mission expects further measures to address flagging Brazilian industry, for autos as well as other sectors, to be announced in February. End Comment.

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